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8 UNITED STATES BANKRUPTCY COURT
9 FOR THE DISTRICT OF OREGON
10

11 In re)	Case No. 11-31975-tmb11
)	
12 Paul Brenneke Qualified Personal)	UNITED STATES TRUSTEE'S
Residence Trust UDT,)	MEMORANDUM IN SUPPORT OF
13)	MOTION TO DISMISS OR
)	CONVERT CHAPTER 11 CASE
14 <u>Debtor</u>)	

15 The United States Trustee, Robert D. Miller Jr. (the "UST"), by and through Trial
16 Attorney Carla G. McClurg, submits this memorandum in support of his Motion to
17 Dismiss or Convert Chapter 11 case filed separately herewith.

18 **FACTUAL HISTORY**

19 In or about 2001, Paul Brenneke ("Brenneke") purchased real property located at
20 11710 SW Summerville Avenue, Portland, OR (the "Residence"). On or about
21 November 5, 2004, Brenneke signed a trust agreement to create the Paul Brenneke
22 Qualified Personal Residence Trust UDT (the "Trust") by which he transferred the
23 Residence to the Trust to create an irrevocable qualified residence trust within the
24 meaning of the Internal Revenue Code. The Trust terminates on the earlier of
25 November 5, 2029, or the date of Brenneke's death. Brenneke, his children, and his
26 wife, Elene Dunavan ("Dunavan") have lived in the Residence since Brenneke

1 purchased it.

2 The beneficiaries of the Trust are Brenneke's minor children. Under the trust
3 agreement, the trustee of the Trust is prohibited from holding any assets other than the
4 Residence, policies of insurance on the Residence, and funds contributed or paid for the
5 maintenance, improvement, or sale of the Residence.

6 Brenneke's brother, Thomas Brenneke ("Thomas"), agreed to serve as the
7 trustee. By or before January 2011, the relationship between Brenneke and Thomas had
8 deteriorated. In or about January 2011, Brenneke through his attorney Robert S. Simon
9 requested that Thomas resign as trustee of the Trust, and Thomas refused to resign.

10 On or about March 1, 2011, Brenneke signed an Amendment of the Paul
11 Brenneke Personal Residence Trust (the "Amendment") purporting to make several
12 amendments to the Trust. The purported amendments included adding language
13 providing:

14 The assets of the Trust shall be used for business purposes. The
15 Trustee shall manage the income from the earnings of the Trust
16 which is derived from the investment of the proceeds of the equity
17 of the Residence, and such investment income shall first be used to
make all payments due on the Residence, and second reinvested to
generate more income for the Trust, all for the purpose of creating a
business income stream for the Trust.

18 The purported amendments also included the following: "If Thomas Brenneke is or
19 becomes unwilling or unable to serve as Trustee, then Jimmy Drakos shall automatically
20 be appointed to serve." Jimmy Drakos ("Drakos") is a long-time family friend and
21 business associate of Brenneke.

22 The Residence was scheduled to be sold at a foreclosure sale on March 17, 2011
23 pursuant to a Notice of Default recorded on November 5, 2010.

24 This case was commenced by the filing of an involuntary petition against the
25 debtor by the Z&A Irrevocable Trust UDT (the "Z&A Trust"), Elene Dunavan
26 ("Dunavan"), Victor Le Nettoyeur LLC, and D&J Remodeling on March 14, 2011

1 against the Trust.

2 Drakos was listed on the involuntary petition as the trustee of the Z&A Trust and
3 as the manager of Victor Le Nettoyeur, LLC. The beneficiaries of the Z&A Irrevocable
4 Trust are Brenneke's minor children. Dunavan is Brenneke's wife and mother of the
5 beneficiaries of the Trust. Victor Le Nettoyeur LLC is owned as follows: 99 percent by
6 the Z&A Trust and 1 percent by the Dunavan Family Trust UDT (the "Dunavan Trust").
7 Dunavan is the trustee of the Dunavan Trust.

8 On the involuntary petition, Drakos represented that the Z&A Trust held a claim
9 of \$1,979,949 against the Trust and that Victor Le Nettoyeur, LLC held a claim of
10 \$157,096 against the Trust. Dunavan represented on the involuntary petition that she
11 held a claim of \$1.2 million against the Trust. Dave Jones represented on the
12 involuntary petition that D&J Remodeling held a claim of \$367,511 against the Trust.

13 Mr. Simon signed the involuntary petition as the attorney for the Z&A Trust,
14 Victor Le Nettoyeur, LLC, and Dunavan. On the petition date, the State of Oregon
15 Circuit Court for the County of Multnomah entered an order authorizing Mr. Simon to
16 withdraw as counsel for the Trust (i.e., the debtor) in a civil foreclosure action entitled
17 Western Pacific Building Materials, Inc. v. David McPherson Jones dba D&J
18 Remodeling, et al., Case No. 0904-05801. The Trust and two petitioning creditors were
19 named as defendants in the civil foreclosure action.

20 An involuntary summons was issued by the court on March 15, 2011. On or
21 about March 21, 2011, Thomas resigned as trustee of the Trust due to the Trust's
22 agreement to indemnify him on account of his personal guaranty of a loan in default
23 from Frontier Bank¹ secured by the Residence. On April 4, 2011, Mr. Simon filed a
24 Certification of Service indicating that Thomas, as trustee of the Trust, had been served
25 personally with the summons and involuntary petition on April 1, 2011. Even though
26

¹ The UST understands this note is now held by Union Bank. See Schedule D.

1 Thomas had resigned, Mr. Simon filed a Memorandum on April 4, 2011 indicating that
2 Thomas, as the trustee of the Trust, was the person to perform the duties of the debtor.

3 On May 4, 2011, Mr. Simon filed a Motion to Enlarge Time to Answer Summons
4 on behalf of Victor Le Nettoyeur LLC, the Z&A Trust, Dunavan, and David Jones (the
5 principal of D&J remodeling) requesting a 60-day extension of time for the Trust to file
6 an answer to the involuntary petition. The stated reason for the extension was that the
7 “moving party” became aware that the trustee for the Trust and the alternative trustee
8 had resigned, and the Trust needed additional time to respond until a replacement trustee
9 could be appointed. On May 12, 2011, the court entered an order extending the deadline
10 for the Trust to answer the involuntary petition through and including July 5, 2011.

11 On or about July 4, 2011, Dunavan agreed to serve as trustee for the Trust and
12 signed a Resolution and Amendment accepting her appointment as trustee. On July 5,
13 2011, a letter dated July 4, 2011 signed by Dunavan was filed with the court. In the
14 letter, Dunavan represented that she would “drop” her claim against the Trust and was
15 appointed as the new trustee. Dunavan requested additional time to locate an attorney to
16 represent the Trust. Pursuant to an order entered on July 21, 2011, the court extended
17 the deadline for the filing of an involuntary answer through August 5, 2011.

18 On August 5, 2011, the Trust filed an answer to the involuntary petition
19 representing that it was not paying its bills as they became due and requesting that an
20 order for relief be entered. An order for relief under chapter 11 was entered on
21 August 8, 2011.

22 On or about August 22, 2011, Dunavan signed schedules, Statement of Financial
23 Affairs, and related documents (the “Bankruptcy Documents”) under penalty of perjury
24 on behalf of the Trust. The Bankruptcy Documents were filed on August 22, 2011.
25 The Bankruptcy Documents reflect that the assets of the Trust include the Residence
26 valued at \$4.2 million; a note payable owed by GM Pine Street Garage Fund, LLC in the

1 amount of \$1,068,271; and claims against Thomas valued at \$1 million. Schedule D
2 reflects a total of \$5,157,752.14 in claims secured by the Residence. Schedule D
3 reflects two unsecured claims for construction work in the total amount of \$442,511.00.

4 Dunavan testified under oath as representative of the Trust at the meeting of
5 creditors on September 12, 2011. At the meeting of creditors, Dunavan testified that she
6 agreed to accept the appointment as trustee of the Trust in order to save the Residence
7 from foreclosure. At the meeting of creditors, Dunavan testified that her position had
8 changed since the petition date. When asked about the basis for the debt Dunavan listed
9 on the involuntary petition of \$1.2 million, she testified that she was not sure. Dunavan
10 speculated that the debt had to do with monies she and Brenneke borrowed that were
11 thereafter loaned to Thomas. Dunavan testified that she did not make any demands for
12 payment on the debt to the Trust. Dunavan testified that it was Brenneke's idea that she
13 join the involuntary petition as a creditor.

14 Dunavan testified that the only income of the Trust consists of funds provided by
15 Brenneke. No cash or bank accounts were listed on Schedule B. Dunavan testified that
16 Schedule B was correct in not disclosing any cash or bank accounts. Dunavan testified
17 that the \$500 deposited into the Trust's debtor-in-possession account was contributed by
18 Brenneke. Dunavan testified that she believed that the mortgage payment on the
19 Residence was approximately \$18,000 per month and that a payment had not been made
20 for approximately one year.

21 Dunavan testified that she was not sure how the value of \$4.2 million for the
22 Residence listed on Schedule A was determined. Dunavan testified that she assumed
23 that Brenneke determined the value listed on Schedule A.

24 Dunavan testified that she did not have any knowledge about the note payable
25 owed by GM Pine Street Garage Fund, LLC to the debtor listed on Schedule B valued at
26 \$1,068,271. Dunavan testified that Brenneke would have information regarding the note

1 payable. Dunavan also testified that she believed Brenneke is the principal of GM Pine
2 Street Garage Fund, LLC.

3 GM Pine Street Garage, LLC² filed a voluntary chapter 11 petition in the Western
4 District of Washington on June 23, 2011, Case No. 11-17493-KAO. The bankruptcy
5 case for GM Pine Street Garage, LLC is still pending. The Trust is not listed as a
6 creditor on the schedules for GM Pine Street Garage, LLC. Drakos signed the petition,
7 schedules, and Statement of Financial Affairs on behalf of Willamette Capital Group
8 LLC, the manager of GM Pine Street Garage, LLC. The mailing address for GM Pine
9 Street Garage, LLC is: c/o Robert S. Simon, Sellwood Station, Portland, OR 97282-
10 1035.

11 Regarding the claim against Thomas in the amount of \$1 million listed on
12 Schedule B, Dunavan testified that she thought the claim related to monies loaned to
13 Thomas that were not repaid. Dunavan testified that she was not involved in the
14 transaction and that Brenneke would have information regarding the transaction. Despite
15 Dunavan's unfamiliarity with the basis of the claim against Thomas, she testified that
16 the Trust intends to fund its plan by pursuing the claim against Thomas.

17 **III. LEGAL ANALYSIS**

18 **Dismissal under 11 U.S.C. § 1112(b) for Cause**

19 The court has jurisdiction over this contested matter pursuant to 28 U.S.C. §§ 157
20 and 1334. This matter is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A) and
21 (O). Pursuant to 11 U.S.C. § 307, the United States Trustee may raise, appear, and be
22 heard on any issue in any case or proceeding under Title 11.

24
25 ² The UST intends to conduct discovery regarding whether GM Pine Street Garage,
26 LLC is the same entity as GM Pine Street Garage Fund LLC. According to the Oregon
Secretary of State website, neither entity is organized in Oregon. The Washington
Secretary of State website indicates that GM Pine Street Garage, LLC is a Delaware limited
liability company.

1 **A. Cause for dismissal of this case is established.**

2 Section 1112(b) of the Bankruptcy Code provides that the court shall convert a
3 chapter 11 case to one under chapter 7 or dismiss a chapter 11 case, whichever is in the
4 best interest of creditors and the estate, if the movant establishes “cause.” The
5 Bankruptcy Abuse and Consumer Protection Act of 2005 (“BAPCPA”) expanded the
6 definition of “cause” for relief under § 1112(b) and limited the court’s discretion under
7 section 1112(b) once the movant establishes cause. See 11 U.S.C. §§ 1112(b)(1), (b)(2).
8 Prior to BAPCPA, section 1112(b) provided that a court “may” convert or dismiss a
9 chapter 11 case for cause. See In re Prods. Int’l Co., 395 B.R. 101, 108 (Bankr. D. Ariz.
10 2008).

11 Section 1112(b) includes a non-exhaustive list of examples of “cause” for the
12 dismissal or conversion of a chapter 11 case. 11 U.S.C. § 1112(b)(4); see In re
13 Consolidated Pioneer Mortg. Entities, 248 B.R. 368 (9th Cir. BAP 2000) (the list of
14 cause in section 1112(b) is illustrative rather than exhaustive).

15 **1. Lack of Eligibility**

16 Although not enumerated in § 1112(b)(2), lack of eligibility to be a debtor is
17 cause for dismissal. Only a “person” as defined by 11 U.S.C. § 101(41) may be a debtor
18 under Title 11. 11 U.S.C. § 109(a). A “person” includes an individual, partnership and
19 corporation. 11 U.S.C. § 101(41). A “corporation” is defined to include a business
20 trust. 11 U.S.C. § 101(9)(A)(v). A trust is therefore eligible for relief under Title 11
21 only if it is a business trust. See In re Hunt, 160 B.R. 131, 135 (9th Cir. BAP 1993).

22 Bankruptcy courts have consistently denied family and estate planning trusts the
23 standing to pursue bankruptcies. See In re Sung Soo Rim Irrevocable Intervivos Trust,
24 177 B.R. 673, 678 (Bankr. C.D. Cal. 1996). Unlike business trusts, family and estate
25 planning trusts are almost always governed by state probate and estate laws, which offer
26 an alternative forum for resolution of problems arising under the trust. Id. at 678. The

1 burden of establishing eligibility lies with the party filing the bankruptcy petition. In re
2 the Karoly Vandel Foldesi and Margaret Foldesi Family Land Trust #3, 2003 WL
3 25273865 (Bankr. D. Idaho 2003) (Case No. 02-03410) (citing Montgomery v. Ryan (In
4 re Montgomery), 37 F.3d 413, 415 (8th Cir. 1994)).

5 Functional tests for identifying business trusts include a demonstrated business
6 purpose, transferability of interests, and continuity of existence uninterrupted by death
7 among beneficial owners. In re Sung Soo Rim Irrevocable Intervivos Trust, 177 B.R. at
8 677.

9 The Trust is an irrevocable qualified residence trust. Under the original trust
10 agreement, the assets of the Trust were limited to the Residence, policies of insurance on
11 the residence, and funds contributed or paid for the maintenance, improvement, of sale
12 of the Residence.

13 In this case, the Trust consented to the entry of an order for relief and has the
14 burden of establishing its eligibility to be a debtor. The language in the Amendment
15 regarding the Trust assets being used for a business purpose is without substance. The
16 Trust was established for purpose of holding the Residence for the benefit of Brenneke's
17 children and for tax planning. The Trust has no income other than amounts contributed
18 by Brenneke. The Trust's purpose is not a business purpose. Therefore, the Trust is not
19 eligible to be a debtor under Title 11.

20 **2. Bad Faith**

21 Although not enumerated in § 1112(b)(2), lack of good faith in filing a chapter 11
22 petition establishes cause for dismissal. In re Marsch, 36 F.3d 825, 828 (9th Cir. 1994).
23 "The existence of good faith depends on an amalgam of factors and not upon a specific
24 fact." Id. (citing In re Arnold, 806 F.2d 937, 939 (9th Cir. 1986)). The test is whether a
25 debtor is attempting to unreasonably deter and harass creditors or attempting to effect a
26 speedy, efficient reorganization on a feasible basis. Id. Collusion in the filing of a

1 bankruptcy petition is cause for dismissal if there appears to be concerted action
2 between the debtor and petitioning creditors and these parties fraudulently invoke the
3 jurisdiction of the bankruptcy court. In re Valdez, 250 B.R. 386, 390 (D. Or. 1999).

4 This case was commenced in bad faith. It appears that the involuntary petition
5 was filed to force Thomas to resign as trustee of the Trust and to save the Residence
6 from foreclosure. All of the petitioning creditors, except D&J Remodeling, include the
7 persons residing in the Residence or entities owned or controlled by them. The
8 beneficiaries of the Trust are also the beneficiaries of the Z&A Trust, a petitioning
9 creditor and holder of an interest in 99 percent of Victor Le Netoyeur LLC, another
10 petitioning creditor. Dunavan testified at the meeting of creditors that it was Brenneke's
11 idea that she sign the involuntary petition as a creditor, and she was unable to articulate
12 the basis of her claim listed on the involuntary petition.

13 Mr. Simon has represented the Trust, Brenneke, the Z&A Trust, Victor Le
14 Netoyeur LLC, Dunavan, and, possibly, D&J Remodeling as their attorney. Mr.
15 Simon's representation of the Trust through the eve of the filing of the involuntary
16 petition and representation of creditors filing the involuntary petition against the Trust
17 further supports the conclusion that the Trust and most of the creditors that signed the
18 involuntary petition colluded to improperly invoke the protections of the Bankruptcy
19 Code.

20 **3. Substantial or Continuing Loss to or Diminution of the Estate and the**
21 **Absence of A Reasonable Likelihood of Rehabilitation**

22 Under § 1112(b)(4)(A), "substantial or continuing loss to or diminution of the
23 estate and the absence of a reasonable likelihood of rehabilitation" constitutes cause for
24 the dismissal or conversion of a chapter 11 case. Therefore, under § 1112(b)(4)(A), the
25 movant must establish both (i) a continuing loss to or diminution of estate assets, and (ii)
26 an absence of a reasonable likelihood of rehabilitation. In re Wahlie, 417 B.R. 8, 11

1 (N.D. Ohio 2009). In determining if there is a loss or diminution of estate assets, the
2 court considers whether the debtor has suffered or continues to experience negative cash
3 flow, or, alternatively, declining asset values. Id.

4 The Trust has not made a mortgage payment on the Residence for approximately
5 a year. The Trust did not have cash or bank accounts on the petition date. The Trust
6 does not have any income other than what Brenneke contributes. There is no equity in
7 the Residence. Dunavan could not provide information at the meeting of creditors
8 regarding the note payable owed by GM Pine Street Garage Fund, LLC or the claim
9 against Thomas listed on Schedule B. It appears that GM Pine Street Garage Fund, LLC
10 is the same entity as GM Pine Street Garage, LLC, the debtor in a Washington
11 bankruptcy case in which the Trust is not listed as a creditor. Thomas may assert an
12 indemnity claim against the Trust and dispute liability on the claim listed on Schedule B.
13 The Trust's intention to fund its plan by pursuing the claim against Thomas is
14 speculative at best. The Trust should not be permitted to remain in chapter 11 to pursue
15 a speculative and likely contentious claim better suited for resolution in state court.

16 **B. Dismissal is in the best interests of creditors and the estate.**

17 Pursuant to § 1112(b)(1), once cause has been established, the court must
18 determine whether conversion or dismissal is "in the best interests of creditors and the
19 estate." In re Owens, 552 F.3d 958, 959 (9th Cir. 2009). Dismissal of this case would be
20 in the best interests of creditors. The total amount of secured claims substantially
21 exceed the value of the Residence. Recovery on the note by GM Pine Street Garage
22 Fund, LLC and on the claim against Thomas would be speculative at best. Moreover,
23 the Trust is not eligible to be a debtor under any chapter of the Bankruptcy Code.

24 **IV. CONCLUSION**

25 This case should be dismissed. The Trust is not eligible to be a debtor under the
26 Bankruptcy Code. The involuntary petition was filed as a result of collusion between

1 the Trust and certain creditors. The Trust has no assets other than the Residence and
2 speculative claims.

3 DATED this 21st day of September, 2011.

4 Respectfully submitted,

5 ROBERT D. MILLER JR.
6 United States Trustee

7 /s/ Carla G. McClurg
8 CARLA G. McCLURG, CSB# 227738
9 Trial Attorney
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1 **CERTIFICATE OF SERVICE**

2 I hereby certify that on September 21, 2011, I served a copy of the foregoing
3 UNITED STATES TRUSTEE'S MEMORANDUM IN SUPPORT OF MOTION TO
4 DISMISS OR CONVERT CHAPTER 11 CASE by mailing a copy of this document, by
5 United States first class mail, postage prepaid, addressed to the following:

6 Paul Brenneke Qualified Personal Residence Trust UDT
7 710 NW 14th Ave, 2nd Fl
8 Portland, OR 97209

9 Jones Dave D&J Remodeling
10 20672 NW Quail Hollow
11 Portland, OR 97229

12
13 ROBERT D. MILLER JR.
14 United States Trustee

15 /s/ Carla G. McClurg
16 CARLA G. McCLURG, CSB 227738
17 Trial Attorney
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